

SINGAPORE

ECONOMIC OUTLOOK MID-YEAR 2003 – Signs Of Rebound After Worse-Than-Expected 2nd Quarter

July 18, 2003

S U M M A R Y

Singapore's economy contracted sharply in the second quarter (Q2) of 2003, down 11.8% quarter-on-quarter (q/q) and 4.3% year-on-year (y/y), according to advance government estimates based on full-month data for April and May. The outbreak of Severe Acute Respiratory Syndrome (SARS), beginning in mid-March, aggravated an already ailing economy that had narrowly averted falling back into recession in the last quarter of 2002. The consensus forecast for CY2003 growth is now under 1.0%, a significant change from the 3.8% consensus forecast earlier this year. Almost all analysts have cut their CY2003 GDP growth forecasts. In May, the government officially downgraded its own forecast to between 0.5% and 2.5%; some analysts expect a further downgrade in August, although government officials are more optimistic.

The weak performance stems from both internal and external factors. Internally, the delicate improvement in the services sector in Q4 2002 dissipated in the first half of 2003 (H1 03). Uncertainty over Iraq and then SARS hit the hospitality, retail sales and travel-dependent services sectors hard. External demand remains sluggish. Manufacturing output, which has largely propelled growth in recent years, has not provided a major boost in 2003, with cumulative output for the January-May 2003 period rising just 0.4% y/y; a 6.0% y/y rise in manufacturing output in Q1 was followed by a 7.5% y/y drop in output in Q2. The key electronics sector is still sputtering given the lack of global IT demand; biomedical and chemical exports initially propped up growth, although biomedical output slid in Q2.

But the worst now appears over, and looking ahead, the outlook is for a pickup in the third quarter, and a stronger recovery in the last quarter of the year. Singapore's removal from the list of SARS-affected areas, a strong rebound in visitor arrivals, positive export and manufacturing data and recent favorable U.S. macroeconomic signs suggest a rebound is underway. June export data was better than expected, up 19% y/y, following weak data in May. Non-oil domestic exports, the main gauge of export performance, grew 15% in the first half of 2003. The Purchasing Managers Index (PMI) turned positive in June, to 50.8%, signaling expansion, after declines in March, April and May. But unemployment data remains gloomy, increasing to 4.5% (seasonally-adjusted) as of end-March, the latest data available, from 4.2% as of end-December 2002. The Government has recommended wage cuts and freezes as a means of preserving employment.

Given Singapore's dependence on external demand, a strong U.S. recovery in the U.S. would provide an important boost for Singapore. Internally, Singapore's very open economy and small size mean that options to stimulate domestic demand are limited. The Government in April announced a SARS relief package of US\$130 million, which is targeted at certain SARS-affected sectors. Action by the Monetary Authority of Singapore (MAS) on July 10 to ease monetary policy slightly, by adjusting downwards the band within which it manages the Singapore Dollar, should also provide additional lift, albeit marginal.

(Singapore Dollar values are converted to U.S. Dollars at end-of-period exchange rates.)

ECONOMY HIT IN H1 03 BY WEAK GLOBAL DEMAND, SARS

Singapore's economic performance in the first half of 2003 was worse than expected, due to uncertainty abroad caused by the Iraq conflict, weak external demand, and the impact of Severe Acute Respiratory Syndrome (SARS) in Singapore. Advance estimates put GDP in Q2 down 11.8% on an annualized q/q basis, and down 4.3%, y/y (the consensus view was for a 1.9% y/y fall). This represents the biggest q/q decline since 2001 and the first y/y decline since. Overall, Singapore's post 2000 GDP performance places the country among the weakest economies in East Asia.

Table: Real GDP Growth

(Quarter/Quarter Percentage Change)

	<u>Q2 02*</u>	<u>Q3 02*</u>	<u>Q4 02*</u>	<u>Q1 03*</u>	<u>Q2 03*</u>
Overall GDP Growth Rate	12.1	(6.6)	0.4	1.1	(11.8)
Manufacturing (24%)	53.9	(18.4)	(3.8)	5.9	n.a.
Construction (6%)	(16.3)	(10.1)	(18.0)	(4.7)	n.a.
Wholesale & Retail Trade (13%)	20.9	(13.0)	6.5	10.8	n.a.
Hotels & Restaurants (2%)	(3.3)	(5.3)	(1.7)	(20.4)	n.a.
Transport & Communications (14%)	4.0	(0.6)	(5.4)	5.1	n.a.
Financial Services (11%)	(16.3)	6.7	12.4	(20.3)	n.a.
Business Services (14%)	1.1	(2.4)	2.9	4.9	n.a.

Notes:

* - Annualized Growth Rate - Seasonally-adjusted q/q

Figures in parentheses denotes negative values

Percentage after respective sectors denotes share of GDP (at 1995 prices, seasonally-adjusted) in Q4 2002

For more information, please refer to the Ministry of Trade and Industry's quarterly economic survey, at: www.mti.gov.sg

Extensive GDP data can be found at the Department of Statistics Internet site: www.singstat.gov.sg

External demand largely drives growth in Singapore. Manufacturing had a robust in Q1 03, with output up 6.5% y/y, but slid in Q2 03, down an estimated 7.5%. Manufacturing output in April fell 6.0% y/y, and a further 9.5% in May, the worst decline in 15 months. Overall, total manufacturing output grew only 0.4% y/y for the January to May period. As during 2002, manufacturing has been sustained by a relatively narrow base, resulting primarily from growth in biomedical (mainly pharmaceuticals) and chemical production; it was a decline in output in the biomedical sector that largely caused manufacturing output to contract in Q2. The electronics cluster, which accounts for 32% of manufacturing value-added and 50% of manufactured exports, grew slightly in Q1 03, but was stagnant in Q2. Growth for the transportation cluster was flat in Q1 03, and dived in Q2 2003, in part due to a high base effect, but also because of a drop in aircraft repair orders and the adverse effects of the SARS epidemic on air travel.

The construction sector continues to contract, a victim mainly of increased competition and declining construction due to the sustained slump in the real estate market. The sector dipped by 12.3% y/y in Q1 and a further 10.9% in Q2, these are the latest in a long run of double-digit quarterly y/y declines. An example of the problems confronting the sector, total contracts awarded in Q1 2003 fell 44% relative to Q1 2002, with private sector contracts leading the decline. Approximately 3.7 million sq. feet of new office space was constructed in 2002, yet over twice that amount is vacant, the biggest glut in over ten years, according to one property consultant. Office rents fell 16.5% in 2002, on top of a 15.7% decline in 2001.

Singapore's service sector, accounting for just under 65% of GDP, has been very weak as an alternate driver of growth, generally underperforming relative to manufacturing, apart from some areas, such as logistics/transport and travel and tourism-related businesses. But the services sector actually performed better than manufacturing on a y/y basis in Q2 03, a sign of just how sharp the contraction in manufacturing was in Q2. In Q2, the already weak services sector shrank 3.0% y/y compared to an expansion of 0.8% y/y in Q1 03 and 1.5% y/y in Q4 02. Results would have been worse if not for positive entrepot trade data; container volumes handled at the Port of Singapore in Q1 registered their second best performance ever, at 4.19 million twenty-foot equivalent units (TEUs). Buffeted by uncertainty about Iraq and then SARS, cutbacks in business investments and lower spending on financial and recreational goods dampened domestic demand, which posted a decline of 12% y/y in Q1 03.

The travel/tourism, hotel/restaurant and transportation sectors have been hardest hit by the drop in business and leisure activity because of the run up to the Iraq conflict and then SARS; tourism-related industries account for 5% of GDP and employ 12% of the workforce. Visitor spending accounts for 10% of retail spending, according to MTI. Sea and air passenger numbers already fell in the first quarter, down 2.3% y/y and 0.3% y/y, respectively. That drop grew in March, as visitor arrivals fell by 15% m/m, by 62% m/m in April and by a less severe 12% m/m decrease in May. The number of passengers handled at Singapore Changi Airport and by Singapore Airlines (SIA) dropped over 50% in April and May; SIA and other airlines cut back capacity. Many hotels reported occupancy rates under 20% at the height of the SARS outbreak. But by late June, visitor arrivals and hotels reported a robust (and better than expected) recovery.

Singapore's total employment base has contracted for seven consecutive quarters. The first quarter of 2003 saw a net loss of 9,400 jobs, double the loss in Q4 02. Most of the decline came in the manufacturing and construction sectors; there was a slight increase in services jobs. Unemployment increased further in Q1, reaching 4.5% (seasonally-adjusted) as of end-March 03, compared with 4.2% as of end-December 02. According to the Ministry of Manpower, the unemployment rate (seasonally-adjusted) could hit 5.5% and higher should the economic impact of SARS be prolonged. In its annual recommendations released in May, the National Wages Council, a tripartite body bring together representatives of business, labor and government,

called for wage cuts and wage freeze in the private and public sectors. The Government has taken the lead by cutting salaries of Ministers and civil servants.

The Government has provided little in the way of a fiscal stimulus; most analysts agree that Singapore's small, open economy limits the potential impact of fiscal pump priming. The FY2003 budget deferred tax cuts, and while the Government has provided a SARS relief package of S\$230 million (US\$130 million), it is equivalent to only 0.1% of GDP. Officials explicitly stated that the package was not intended to have much effect on the overall GDP growth; rather, it was intended to help those transport/tourism sectors worst impacted by the economic effects of SARS. SARS also impacted government revenues, especially collections from the Goods and Sales Tax (GST), although it is unclear by how much.

Depressed property prices - and the high concentration of retirement assets in property - continue to be a longer-term challenge for policymakers. Sliding housing costs contributed to the marginal 0.4% fall in the Consumer Price Index in 2002; the last time Singapore saw CPI deflation was in 1998 during the Asian Financial Crisis. Recent policy changes have provided mixed signals on the over-investment in property - while the proportion of savings dedicated to retirement has been increased, lending conditions on residential properties have been relaxed. Some analysts say not enough is being done to address the problem. A clear oversupply of residential and office space exists; yet construction continues. Office rents fell 15.5% in 2002, on top of a 15.7% decline in 2001, and a further 3.5% in Q1 2003. Housing rents dropped 2.2% in Q1, following a 0.9% fall in Q4 2002.

OUTLOOK

A highly open and trade-dependent economy, Singapore's economic fortunes are closely linked to changes in external demand. Global economic uncertainty therefore hurts Singapore's own economic prospects. In April the Singapore Government revised its CY2003 GDP growth forecast from 2%-5% real GDP growth to 0.5%-2.5% growth. Prime Minister Goh said on June 8 that economic growth in Q3 would be flat and that whether Singapore might slip into a recession this year would depend on the fourth quarter. MTI has estimated that the SARS outbreak has shaved 1.1-1.6% points off the 2003 GDP growth. Real GDP grew 2.2% in 2002, following a fall of 2.4% in 2001.

But the outlook is improving, and the Monetary Authority of Singapore concludes that the economy should resume a modest recovery path in H2 2003. The World Health Organization's May 31 removal of Singapore from the list of SARS-affected areas has already had a strong positive effect on SARS-hit sectors of the economy. The Government has also launched initiatives to revive tourism-related services; for example, the Singapore Tourism Board unveiled June 5 a S\$200 million package of incentives designed to encourage businesses to attract tourists back to Singapore. While tourist arrivals were up sharply in June, the STB still expects a double-digit y/y decline for 2003 as a whole. Retail sales bounced back in May, and stores report sales at close to 2002 levels during this year's Great Singapore Sale, which ended in mid-July. Of course, a fresh SARS outbreak, either in Singapore or in the region, would reverse recent gains.

Manufacturing and export data send mixed signals on the economic outlook. The trend in manufacturing has been negative: on a three-month moving average basis, manufacturing output dipped 3% in the three months to May, after growing 0.5% in the three months to April, 6.5% for the three months ending in March, and 10.9% for the three months ending in February. Yet looking ahead, June's Purchasing Managers Index (PMI) of 50.8 signaled an expansion in

manufacturing activity; reversing three straight monthly readings below 50 (a reading below 50 indicates a contraction). May's PMI of 49.4 percent was the lowest in 16 months. While the electronics sub-index is still in negative territory, June's reading of 49.7 offers a distinct improvement over May, when the electronics PMI fell to its lowest level since November 2001. It may be too soon, however, to conclude that June's positive PMI data confirms any solid trends.

Recent macroeconomic data from the U.S. give greater reason for optimism and Singapore's latest trade data also suggests a more positive outlook. June export data was better than expected, up 19% y/y, following weak data in May. Non-oil domestic exports, the main gauge of export performance, grew 15% in the first half of 2003. Retained imports in June were the highest in two years, suggesting higher manufacturing output ahead. Overall, the consensus forecast is that manufacturing output will grow 5% in 2003, but services will only see 0.4% growth.

On July 10 the Monetary Authority of Singapore slightly eased monetary policy by re-centering downwards the exchange rate policy band within which it manages the Singapore Dollar (SGD) nominal effective exchange rate (S\$NEER). The action represents a slight depreciation of the SGD relative to the USD, responding to the prevailing direction of the forex markets and in line with recent Federal Reserve rate cut. A few analysts said the move should have come sooner. It is difficult to tell exactly how much of a depreciation the move represents, but probably 1-1.5%; MAS does not make the band public. It is unlikely to make any significant competitive difference. The action is intended to support domestic economic activity, rather than to boost export competitiveness; MAS stated that the current level of the S\$NEER is conducive to supporting the incipient recovery and to maintain domestic price stability. MAS sees the exchange rate as its only real monetary policy tool, given the openness and trade dependence of the economy.

Some analysts expect the Government will narrow its CY2003 GDP growth forecast, perhaps to between 0-1.5%. Government officials appear more optimistic. With the worse-than-predicted data for Q2, many analysts moved quickly to cut their forecast again, with the majority of forecasts for CY2003 growth now within the 0.5-1.0% range. Yet few see any risk of recession, and more positive recent data supports expectations of a clear q/q rebound in Q3. Indeed, while downside risks remain, some analysts may be overly pessimistic. A more robust strengthening of the U.S. economy could provide a strong boost to external demand, propelling CY2003 GDP growth above most analysts' current expectations. We note that many analysts do not have a strong record of getting their Singapore growth forecasts right.

Investment

Singapore attracted US\$600 million in manufacturing investment commitments in Q1 03 (latest data available), down a hefty 58% from Q4 02. Foreign investors continued to make up the larger share of new manufacturing investment commitments, totaling US\$440 million. The U.S. was the leading source of new investment commitments, accounting for US\$230 million (-24% q/q), followed by Japan, with US\$196 million (-65% q/q); commitments from Europe totaled US\$13 million (-85% q/q). Singapore domestic firms committed US\$228 million (-63% q/q) in new investment commitments in manufacturing.

Commitments to the electronics and precision engineering cluster continue to attract the largest share of investments among EDB-promoted clusters, with US\$468 million in Q1 03. The chemicals cluster chalked up US\$160 million worth of commitments. Commitments to the biomedical sciences cluster posted US\$13 million, while the logistics/transport cluster brought in US\$19 million.

Trade

(Unless otherwise stated, percentage comparisons are on a Singapore Dollar, nominal basis)
For the first half of 2003, total trade improved by 0.7% compared to the second half of 2002; gains in Q2 offset a marginal decline in trade in Q1. Total exports edged up by 0.7% q/q in Q1, to US\$34 billion, with non-oil domestic exports (NODX) rising by a slightly higher 1.5% q/q. The up trend continued into Q2 03, with total exports rising by 0.5% q/q and NODX, by 0.6 q/q. Compared to the second half of 2002, NODX rose by 3.3% in the first half of 2003.

Domestic exports of electronics, which account for 54% of overall NODX, fell 6.4% q/q in Q2 03, after a decline of almost 5% q/q in Q1. However, domestic exports of electronics rose 8.3% in June, on a month-on-month (m/m) seasonally-adjusted basis, due to higher shipments of disk drives, integrated circuits (ICs) and parts of ICs. Higher non-electronics domestic exports came from increased pharmaceutical shipments to the U.S. and Europe, and increased petrochemical shipments to Malaysia and India.

Compared to 2H 2002, exports to the U.S. shrank by 3.4% in H1 2003; imports from the U.S. dipped 0.5% over the same period. The trend in exports to the U.S. was positive in H1 - up 8.4% q/q in Q2 03, after a decline of 4.9% q/q in Q1 03 - but imports in general trended downwards, falling 8/8% q/q in Q2 after an increase of 8/4% q/q in Q1. However, imports in June 03 picked by 10.6%, compared to May.

Electronics Trade

(Percent Share)

Q1 03*

Q1 03*

Electronics Exports:

As a percentage of Total Exports	48.6	47.8
To U.S. as percentage of Total Exports	9.7	10.1
To U.S. as percentage of NODX	21.4	22.4
To U.S. as percentage of Electronics Exports	19.9	21.1
Electronics NODX as percentage of NODX	53.8	50.1

** Percentage changes are due to reclassification of HS codes for electronics products*

Source: IE Singapore (formerly Trade Development Board)

Table : Trade (% change quarter-on-quarter*, nominal S\$)

	<u>Q2 02*</u>	<u>Q3 02*</u>	<u>Q4 02*</u>	<u>Q1 03*</u>	<u>Q2 03*</u>	<u>Jun 03*</u>
Total	11.6	2.3	1.9	0.7	0.5	1.8
Exports						
NODX	10.4	4.6	3.1	1.5	0.6	6.5
NODX	5.7	6.6	1.3	(4.4)	(6.4)	5.9
Electronics						
Exports to U.S.	12.7	4.3	(5.0)	(4.9)	8.4	4.6
NODX to U.S.	12.9	6.6	(1.0)	(7.2)	6.2	1.0
Exports to Malaysia	0.0	5.9	(9.8)	(3.9)	9.0	(1.3)
NODX to Malaysia	14.7	(2.7)	(8.7)	(7.5)	6.7	3.2
Exports to E.U.	1.0	3.5	8.3	4.7	(2.1)	5.1
NODX to E.U.	2.3	6.7	11.2	8.6	2.2	11.8
Exports to Japan	7.2	(5.0)	6.6	(4.8)	1.0	(6.5)
NODX to Japan	(0.5)	(3.6)	3.8	5.5	(1.9)	8.1
Exports to China & Hong Kong	18.1	7.0	14.0	2.4	(7.3)	5.2
NODX To China & Hong Kong	23.6	5.1	10.2	2.5	0.4	6.5
Total Imports	12.1	(0.5)	(0.1)	(1.5)	2.1	10.1
Imports from U.S.	9.2	(10.0)	1.9	9.8	(8.8)	10.6

() - Denotes negative values

* - Percent change from previous quarter

** - Percent change from previous month

NOTE: Monthly trade data for Singapore is posted on the Internet at: <http://www.iesingapore.com/>

Balance of Payments

Singapore's overall balance of payments registered a surplus of US\$487 million in Q1 03, compared with a deficit of US\$251 million in Q4 02.

Exchange Rate

The trade-weighted Singapore Dollar (SGD) nominal effective exchange rate (S\$NEER) was on a downward trend through April, but then rebounded by May, appreciating by about 4% against the USD, and other USD-pegged currencies, as the market took its lead from the strengthening of the Japanese Yen and Euro against the USD. By end-June, the SGD weakened by about 1.0% from against the USD, from its peak in mid-May. Against the Euro, the SGD weakened by 6.0% between end-March and June 27. The SGD remained stable against Japanese Yen and the Pound Sterling, until mid-June when it weakened by nearly 2.0% against the Pound. As noted above, the MAS moved on July 10 to re-center its exchange rate policy band at the current level of the S\$NEER, while maintaining a zero percent appreciation path and no change in the width of the band. The move follows the Fed decision to cut interest rates further.

NOTE: More balance of payments and financial sector data is available in the report "Recent Economic Developments in Singapore," posted at the MAS Internet site: <http://www.mas.gov.sg/>

Financial Markets

Trading on the Singapore Exchange in the first half of 2003 trended up 10.6% in volume and 1.2% in value compared to H2 2002. In Q1 03 and into Q2 03, investors generally sat on the sidelines in the run-up to the Iraq conflict and then the onset of SARS. The market rebounded from May 21, rising to a high on June 19, with stocks up 25% from their March low. The Straits Times Index on July 11 was 1,544.84, up 331.02 points from the low point of 1,213.82 registered on March 10. Twenty-four IPOs were launched in the first half of 2003, with the largest being that of Singapore Post. The partial divestment raised some US\$347 million. Market capitalization as of June 27 rose 15% from that of December 31, 2002. As of end-June, Singapore Government-linked companies (GLCs, i.e., government-owned or controlled enterprises) accounted for over 40% of total stock market capitalization.

The 3-month Singapore Dollar interbank rate continued to slide from 0.81 (as of January 3) to 0.63 (as of July 11. Yield on two and five-year Singapore Government Securities issues fell further, to 0.72% and 1.39%, respectively, as of June 27.

CPI Inflation

The consumer price index (CPI) in May 2003 fell by 0.7%, seasonally adjusted, from that of April 2003, and 0.1% compared to that of May 2002.

ECONOMIC INDICATORS

(Note: Data is given in US\$ million units, unless specified otherwise. Data are converted from S\$ values to US\$ terms at end of year exchange rates for 2002 and 2001, and estimated end of year exchange rate for 2002.

	<u>2000</u>	<u>2001</u>	<u>2002 Est.</u>
GDP at Current Market Prices	92,466	82,949	87,000
GDP Growth Rate (%)(<i>at 1990 Market prices</i>)	9.9	-2.0	3.0
GDP per capita (US\$)	23,015	20,090	21,000
Government spending as a % of GDP	11.6	18.1	19.1
Inflation (%)	1.3	1.0	1.0
Unemployment (%)	3.1	3.3	5.0
Foreign Exchange Reserves	80,965	75,644	79,000
Average Exchange Rate (S\$ per US\$)	1.72	1.79	1.80
Foreign Debt Service Ratio	0	0	0
U.S. Economic Military Economic Assistance	0	0	0
Total Country Exports (Domestic plus Re-exports of Transshipments)	138,271	117,852	123,200
Total Country Imports	134,986	112,266	117,200
Exports to U.S. (Domestic plus Re-exports of Transshipments)	23,947	18,127	18,800
Imports from U.S.	20,185	18,452	19,000

Source: Ministry of Trade & Industry, Economic Survey of Singapore, 2001; Economic Survey of Singapore, First Quarter 2002 & Yearbook of Statistics, 2002